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RUEHML/AMEMBASSY MANILA 3037  
RUEHBUL/AMEMBASSY KABUL 9254  
RUEHNE/AMEMBASSY NEW DELHI 3891  
RUEHLO/AMEMBASSY LONDON 8891  
RUEHKP/AMCONSUL KARACHI 0459  
RUEHLH/AMCONSUL LAHORE 6199  
RUEHPW/AMCONSUL PESHAWAR 5033  
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL  
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SUBJECT: PAKISTAN'S Q1 INDICATORS REFLECT ECONOMIC DECLINE

1. (SBU) Summary: First quarter economic performance indicators reflect a continuing decline in the country's overall economic stability. Despite pledges to make significant reforms, first quarter data is disappointing as Government of Pakistan (GOP) borrowing from the central bank reached new highs, soaring imports created a wider trade imbalance, the rupee has depreciated more than 35 percent since September 2007 and the State Bank of Pakistan's (SBP) foreign exchange reserves touched new lows. Headline inflation more than trebled from the last quarter. However, inflation dropped in September compared to August due to a decrease in food inflation. In the first quarter, the GOP utilized 46 percent of the total annual budget amount for fuel subsidies. The only bright spots of Pakistan's economy have been remittances and tax collection which grew by 25 percent and 27 percent respectively. End summary.

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BORROWING INCREASES  
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2. (SBU) Despite pledges to the contrary, government budgetary borrowing from the banking system surged 98 percent in the first quarter of FY09, mainly due to increasing expenditures. The SBP's statistics reveal that from July 1 to September 27, the government budgetary borrowing from the banking system - SBP and commercial banks combined - increased to PKR 148.58 billion (USD 1.81 billion at 81.9 rupees to dollar exchange rate) compared to PKR 74.97 billion (USD 915 million) in the same period last year. The GOP borrowing from the State Bank of Pakistan soared to PKR 264.43 billion (USD 3.22 billion) in the first quarter compared to the retirement of PKR 8.84 billion (USD 107 million) of debt in the same period of the last fiscal year. Faced with a drop in foreign inflows and no proceeds from privatization, the GOP was compelled to resort to more borrowing for budgetary support from the local banking system. Based on past debt servicing trends, Pakistan will have an estimated USD 1.23 billion of cumulative debt payments due in February 2009.

3. (SBU) Despite growing concerns about Pakistan's ability to finance a large import bill, imports continue to grow at an exorbitant rate. Imports swelled by 34.2 percent to USD 10.8 billion year-on-year in the first quarter, yet exports increased only 19 percent during this same period to USD 5.2 billion, which is about half of the import value. The trade imbalance has widened to a negative of USD 5.55 billion in the first quarter versus a negative of USD 3.63 billion in the same period last year. Pakistan continues to deplete its foreign exchange reserves to finance its growing trade deficit. The foreign exchange reserves with the SBP

have continued to decline and now stand at USD 4.01 billion on October 16. The Pakistani rupee has depreciated more than 35 percent against the dollar since September 2007 and continues to be under immense pressure due to the significant drop in the foreign exchange reserves. Per the SBP, on October 16 the official closing rate for the rupee was 81.9 per dollar.

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INFLATION DOWN SLIGHTLY DUE TO RAMADAN PRICING  
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14. (SBU) Continuous price hikes and inflation worries continue to plague the economy. Headline inflation stood at 24.5 percent in the first quarter of the current fiscal year. Inflation has more than trebled during this period, from 7.1 percent to 24.5 percent. Headline inflation is mainly driven by food inflation, which spiked at 32.6 percent in the first quarter compared to 10 percent in the same period last year. Though international commodity prices are largely responsible for Pakistan's inflation woes, the large scale smuggling and hoarding of food products are also contributory factors. However, inflation is down from 25.3 percent in August 2008 to 23.9 percent in September 2008 mainly due to a drop in food inflation from 34.1 percent to 29.9 percent. (Comment: Post believes this slight drop month on month is due to government controlled pricing of food during the Holy Month of Ramadan. End Comment.)

15. (SBU) Although confronted with many challenges and negatives, Pakistan's economy does show a bright spot in the form of increased remittances. Pakistan's fiscal year 2009 first quarter (July-September) workers' remittances measured USD 1.87 billion as

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compared to USD 1.5 billion the year before, up 25.2 percent. Remittances amounted to USD 660.3 million in September 2008 showing an increase of 27.9 percent over same the month of last year. Due to the increasing numbers of Pakistanis seeking work abroad, remittances continue to surge despite Pakistan's weak economic fundamentals. The inflows of the workers' remittances in 2007-08 breached the USD 6.45 billion mark for the first time in the history of the country, with the year-on-year increase of 17.4 percent. Building on the same positive trend, remittances have continued to rise in the current fiscal year. The GOP has set a target of USD 7.5 billion for remittances in the current fiscal year. An increase of 25.2 percent in the first three months of the current fiscal year suggests that the remittances target is most likely going to be achieved.

16. (SBU) The United States continues to be the largest source of workers' remittances, accounting for 26.5 percent of total remittances (USD 499.6 million), followed by Saudi Arabia (USD 398.0 million or 21.1 percent), other Gulf Cooperation Council Countries (Bahrain, Kuwait, Qatar, and Oman - USD 315.3 million or 16.7 percent), UAE (USD 312.1 million or 16.6 percent), UK (USD 118.5 million or 6.3 percent) and USD 135.6 million or 7.2 percent from the rest of the world.

17. (SBU) The Federal Board of Revenue (FBR) collected PKR 260.2 billion (USD 3.22 billion) during the first quarter of the current fiscal year (2008-09) as compared to PKR 205.1 billion (USD 2.50 billion) in the same period of last year - posting a healthy increase of 26.9 percent. Federal tax collection has also surpassed the target of PKR 250.8 billion (USD 3.06 billion) set for the first quarter of FY09. In the month of September alone, FBR collected PKR 110.2 billion (USD 1.34 billion) bolstered by 47.6 billion (USD 581 million) in direct taxes and 62.5 billion (USD 763 million) from indirect taxes such as the general sales tax and excise duties.

18. (SBU) A breakdown of tax collection shows that all tax components have registered positive growth. Direct taxes, which contribute 33.8 percent of total tax collection, have registered a growth rate of 13.8 percent. Indirect taxes, however, exhibited impressive growth of 34.8 percent. Within indirect taxes, sales tax, which accounts for roughly 64 percent of indirect taxes and 42.2 percent of total taxes, grew by 32.9 percent. Sales tax collected from domestic economic activity is up by 54.1 percent, while sales

tax collected from imports grew by 17.2 percent. Customs duty collection is up by 31.7 percent and the collection of federal excise duty has recorded a significant increase of 49.9 percent. The FBR collected PKR 1007 billion (USD 12.3 billion) in FY 2007-08 and the GOP has set a target of PKR 1250 billion (USD 15.26 billion) in the current fiscal year, targeting an increase of 24 percent. The tax collection figures for the first three months of FY09 suggest that this year-end target is likely to be achieved.

19. (SBU) Pakistan's oil subsidies totaled PKR 65 billion (USD 793 million) in the first quarter while power subsidies measured PKR 18 billion (USD 219 million). The GOP allocated an amount of PKR 140 billion (USD 1.7 billion) for fuel subsidies for FY2008-09. The GOP has already utilized 46 percent of this amount for paying fuel subsidies in the first quarter.

FEIERSTEIN